Section 3.9

**Activity 3.9.1**

1. A ‘budget’ is a detailed financial plan for the future use of resources by an organisation.
2. Reasons why budgeting is important to Kinibali Timber Ltd include:

* Being a vital part of the planning process
* It helps to make sure resources are used effectively
* It helps to set targets.

1. Variances for Kinibali Timber Ltd:

|  |  |  |  |
| --- | --- | --- | --- |
| $’000 | **Budgeted figures** | **Actual figures** | **Variances** |
| Sales revenue  Direct labour  Direct materials  Fixed costs  Profit | 660  150  120  60  330 | 700  180  170  50  300 | 40 (F)  30 (A)  50 (A)  10 (F)  30 (A) |

1. Variances might be useful to managers because they can:

* Show the performance of different parts of the organisation against budgeted objectives
* Motivate workers to achieve budgeted objectives.

1. Kinibali Timber Ltd’s problems seem to be controlling its:

* Direct labour cost
* Direct material cost.

**Exam practice question**

1. ‘Variance’ is the difference between an actual figure and a budgeted figure.
2. A manufacturing business sets budgets for sales and costs by:

* Setting the sales budget based on past data and market research
* Setting direct cost budgets based on sales activity levels.

1. Problems of trying to budget for the cost of raw materials include:

* The cost is affected by activity levels that may be unpredictable
* The market price of raw materials might be volatile.

1. Completed table:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Budgeted figures ($000)** | **Actual figures ($000)** | **Variances** |
| Sales revenue  Cost of materials  Labour costs  Gross profit  Overheads  Net profit | 165  80  22  63  40  23 | 150  70  23  57  43  14 | 15(A)  10(F)  1(A)  6(A)  3(A)  9(A) |

1. The performance of Oasis Cookers is relatively poor in terms of adverse:

* Sales revenue
* Labour cost
* Overheads
* Gross profit
* Net profit

The performance area which is relatively good in terms of favourable variance is:

* Cost of materials.

**Key concept question**

Budgeting can be used to support business strategy through:

* Guiding strategic decision-making
* Business planning
* Setting objectives
* Allocating resources efficiently
* Giving managers responsibility
* Assessing performance

The problems of applying budgets might be:

* Forecasting future use of resources
* Interpreting why actual figures might be different to budgeted figures.